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Credit Tightens, Demand Falls
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Banks are tightening lending standards for businesses and consumers -- even beyond real-estate loans -- and companies' demand for credit has weakened, a new Federal Reserve survey of senior bank-loan officers shows.

The January survey offers the hardest evidence yet that the credit crunch is spreading. Although banks also reported some tightening of lending requirements on credit cards and other consumer loans, commercial and industrial loans have been the most severely affected.

One-third of the U.S. banks and about two-thirds of the foreign banks responding told the Fed they had tightened lending standards on commercial and industrial loans during the three months ended Jan. 31. About half the banks said they have widened the spread between their cost of funds and what they are charging borrowers.

"Bankers are becoming more cautious," said Keith Leggett, economist at the American Bankers Association in Washington, "but also borrowers are getting more cautious."

About a third of the banks participating in the survey reported weaker demand for commercial and industrial loans, while about one in 10 reported strong demand. Among those that saw a reduced appetite for loans, "a decrease in customers' needs to finance inventories and investment in plant and equipment" was cited frequently. Additionally, 70% of the respondents cited a drop in businesses' needs for merger-and-acquisition financing as a reason for lower demand.

In the Atlanta area, for example, the housing-sector slump has trickled down "to all types of business . . . [and is] really starting to hit into the [commercial and industrial] world," said Michael Knowles, chief executive of NorthWest Bank & Trust, an Acworth, Ga., lender with about $134 million in assets. That is prompting banks to rein in their lending, even when it comes to projects that aren't related to the real-estate sector.

"The easy credit has gone away," Mr. Knowles said. "Everything is scrutinized to a higher degree now."

The survey also found that 80% of U.S. banks tightened terms on commercial real-estate loans during the period, the highest percentage since the survey question was introduced in 1990; almost half of banks also reported weaker demand for those loans.

"The downturn in housing markets is having a ripple effect into the commercial real-estate market," said the ABA's Mr. Leggett. "It's going to create some challenges for community banks," he added, especially in parts of the country where real-estate prices have plunged the fastest.

With bad loans piling up on banks' balance sheets, some lenders are finding themselves strained for capital. As a result, banks -- especially community lenders with big portfolios of commercial real-estate loans -- are balking at making new loans, even to clients with solid credit histories, said Jerry Blanchard, a partner in the financial-institutions practice at law firm Powell Goldstein LLP in Atlanta.

"They're very inwardly focused right now," Mr. Blanchard said. "They're not making new loans.

They don't have the capacity -- both people and capital."

Yet other banks say that neither they nor their competitors are clamping down. "Certainly not in our footprint have we seen a tightening of credit" in the commercial and industrial area, said Gary J. Roberts, chief executive of First National Bank in Hermitage, Pa. Competition to make loans remains fierce in western Pennsylvania. As a result, banks are racing to slice the rates they are charging on loans -- the opposite of the trend detected in the Fed survey. "I don't know where the Fed's gotten their information," Mr. Roberts said.

Powell Goldstein's Mr. Blanchard said few banks are eager to admit publicly that they are scaling back. "I don't think that anybody particularly wants to advertise that they're not making loans anymore," he said.

On the consumer side, about 55% of the banks said they had tightened lending standards for mortgages and about 60% said they had done so on home-equity lines.